

REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON INXUBA YETHEMBA MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Inxuba Yethemba Municipality, which comprise the statement of financial position as at 30 June 2011, the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages ... to

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (GRAP) and the requirements of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA), and for such internal control as management determines necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996) and section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with International Standards on Auditing and *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance that the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the municipality's preparation [and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Irregular expenditure

7. In terms of section 1 of the MFMA, irregular expenditure constitutes expenditure incurred by a municipality in contravention of, or not in accordance with a requirement of the supply

chain management (SMC) policy of the municipality or any of the municipality's by-laws giving effect to such policy, and which has not been condoned in terms of such policy or by-laws. Payments amounting to R6 783 170 were made in contravention of the SCM requirements. The amount was not disclosed in the financial statements, resulting in irregular expenditure being misstated by R6 783 170.

Property, plant and equipment

8. I was unable to verify the existence of movable tangible capital assets, amounting to R3 496 992 in the financial statements. The entity imposed a limitation on the scope of my work, as the assets with no barcodes could not be verified. The entity's records did not permit the application of alternative audit procedures regarding the existence of movable tangible capital assets.
9. The additions of property, plant and equipment amounting to R28 212 411, as disclosed in note 8 to the financial statements, do not agree to the balance of R26 043 290 as per the fixed asset register.
The municipality did not reconcile the difference of R2 169 121 between the financial statements and the underlying accounting records.
Consequently, the property, plant and equipment balance is overstated by R2 169 121.
I was unable to determine the effect on the other account balances or classes of transactions contained in the financial statements.
10. Completeness of the assets was not verified adequately as the municipality had not identified all its assets and a number of its assets were not recorded in the assets register.

Trade and other payables

11. The unconditional grants of R4 083 381, as disclosed in note 18 to the financial statements, consist of conditional grants of R385 681 and unconditional grants of R3 697 700.
The municipality did not disclose the amounts separately in accordance with sections 104 and 105 of GRAP 23. This has resulted in conditional grants being misclassified as unconditional grants. Unconditional grants are therefore overstated by R385 681.

Clearing suspense accounts

12. Supporting documentation could not be provided for the accounts receivable clearing account balance of R2 370 118 (2010: R2 370 118), as disclosed in note 6 to the financial statements. The municipality's records did not permit the application of alternative audit procedures regarding the accounts receivables clearing account.
Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the existence, completeness, valuation and allocation of and obligations pertaining to the accounts payable clearing account balance.

Cash and cash equivalents

13. The municipality could not provide sufficient appropriate audit evidence to support journal entries of R2 337 811 and R395 310 debited and credited, respectively, to cash and cash equivalents.
There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that these journals processed in respect of cash and cash equivalent were properly recorded.

Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the existence, completeness, valuation, cut-off and classification of the journals with a net effect on cash and cash equivalents of R1 942 500.

Employee-related costs

14. Section 3.1.5 of the *South African Local Government Bargaining Council Main Collective Agreement on Conditions of Service, 2007*, requires that no accrued leave be in excess of 48 days.

The municipality's leave records were not kept up to date and thus resulted in leave day balances of employees being in excess of the 48-day maximum. Therefore the leave that should have been forfeited during the year under review was not correctly accounted for in the municipality's leave records.

This has resulted in the employee-related costs and the trade and other payables, as contained in note 14 to the annual financial statements, being overstated by R343 798.

15. Due to missing documentation amounting to R138 870, leave balances not captured on the system amounting to R264 226, disagreements between leave records and the leave system amounting to R102 694, and the prior year misstatement of R 745 359 not being corrected, the accumulated misstatement in the leave accrual disclosed in note 14 to the financial statements amounts to R1 594 947.

For this reason I could not confirm the completeness and valuation of the leave accrual balance.

16. The employee benefit obligation of R25 032 502, as disclosed in note 19 to the financial statements, does not agree to the balance of R32 102 752 per the actuarial valuation report. The municipality did not reconcile the difference of R7 070 250 between the financial statements and the underlying valuation report.

Consequently, the employee obligation balance is understated by R7 070 250. I was unable to determine the effect on the other account balances or classes of transactions contained in the financial statements.

Commitments

17. No contract management system was in place for the identification and recognition of contracts and there were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all commitments were properly recorded.

I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of commitments as they were not disclosed in the financial statements.

Emphasis of matters

18. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Unauthorised expenditure

19. As disclosed in note 48 to the financial statements, the local municipality overspent its total vote by R7 575 615, resulting in unauthorised expenditure.

Material Impairments

20. As disclosed in notes 5 and 6 to the financial statements, material losses to the amount of R41,4 million were incurred as a result of impairment of trade debtors.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

21. In accordance with the PAA and in terms of *General Notice 1111 of 2010*, issued in *Government Gazette 33872 of 15 December 2010*, I include below my findings on the annual performance report as set out on pages ... to ... and material non-compliance with laws and regulations applicable to the local municipality.

Predetermined objectives

Usefulness of information

The following criteria were used to assess the usefulness of the planned and reported performance:

- **Consistency:** Objectives, indicators and targets are consistent between planning and reporting documents.
- **Relevance:** A clear and logical link exists between the objectives, outcomes, outputs, indicators and performance targets.
- **Measurability:** Indicators are well defined and verifiable, and targets are specific, measurable and time bound.

22. Audit findings:

Consistency:

- **Reported targets and objectives are not consistent when compared with the planned targets and objectives**
 - Twenty-six percent of reported indicators were not consistent when compared with planned indicators.
 - Twenty-four percent of reported targets were not consistent when compared with planned targets.
- **Changes to planned objectives, indicators and targets are not disclosed**
 - All the changes to planned objectives, indicators and targets are not disclosed and explained in the report on predetermined objectives.

Relevance:

- **A clear and logical link does not exist between reported development priorities/objectives, indicators and targets**
 - There is no clear and logical link between the objectives, outcomes, outputs, indicators and performance targets for 59% of development priorities/ objectives included in the annual performance report.

Measurability:

- **Planned and reported targets are not specific, measurable and time bound**

For the selected programmes:

 - Twenty-one percent of planned and reported performance targets are not specific in clearly identifying the nature and the required level of performance;
 - Twenty-three percent of planned and reported performance targets are not measurable in identifying the required performance; and
 - Twenty-one percent of planned and reported performance targets are not time bound in specifying the time period or deadline for delivery.

Reliability of information

The following criteria are relevant to the findings below:

- **Completeness:** All actual results and events that should have been recorded have been included in the annual performance report

23. Audit findings:

Completeness

- **The content of the annual performance report is incomplete**
 - Actual results relating to 38% of planned indicators have not been included in the reported performance information.
- **Key performance indicators are incomplete**
 - The key performance indicators did not include some of the general key performance indicators as prescribed in terms of section 43(1) of the MSA.

Compliance with laws and regulations

Strategic planning and performance management

24. Sufficient and appropriate audit evidence could not be obtained to confirm that the accounting officer of the municipality assessed the performance of the municipality during the first half of the financial year, taking into account the municipality's service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan as required by section 72(1)(a)(ii) of the MFMA.

Proper record keeping on performance matters should be implemented to ensure that complete, relevant and accurate information is accessible and available to support performance reporting.

25. The responsibility of the coordinating of the performance management system (PMS) has not been delegated to the municipal manager per the requirement of section 39(b) of the MSA.
26. The municipality did not establish mechanisms to monitor and review its performance management system per the requirement of section 40 of the MSA.
27. The municipality did not submit all performance information as required by the general notice of 1570 of 2009 to the Public Audit Act, 2004 (Act No. 25 of 2004)

Budgeting

28. The municipality incurred expenditure that was not budgeted for and incurred expenditure in excess of the limits of the amounts provided for in the votes in the approved budget, in contravention of section 15 of the MFMA.
29. The accounting officer did not always submit the monthly budget statements to the mayor and/ or the provincial treasury as required by section 71(1) of the MFMA.

Annual financial statements, performance and annual report

30. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements

identified by the auditors were not adequately corrected, which resulted in the financial statements receiving a qualified audit opinion.

31. The performance report for the financial year under review was not prepared as required by section 46 of the MSA, read with section 121(3)(c) of the MFMA.
32. The annual performance report did not contain a comparison of the performance of the municipality and of each external service provider with development priorities, objectives and performance indicators set out in its integrated development plan, as required by section 46 of the MSA.
33. Measures taken to improve performance were not provided in the performance report, as required in terms of section 46(1)(c) of the MSA.

Audit committee

34. The audit committee did not review the audits of performance management and the municipality's performance management system and make recommendations in this regard to the council of the municipality and did not submit an auditor's report to the council regarding the performance management system at least twice during the financial year, as required by the Municipal Planning and Performance Management Regulation 14.

Internal audit

35. The municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal audit processes, as required by section 45(1)(a) of the MSA and the Municipal Planning and Performance Management Regulation 14.
36. The internal audit processes and procedures did not include assessments of the extent to which the municipality's performance measurements were reliable in measuring the performance of the municipality on key as well as general performance indicators, as required by Municipal Planning and Performance Management Regulation 14.

Asset management

37. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which accounts for the assets of the municipality, as required by section 63(2)(a) of the MFMA.
38. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained an effective system of internal control for assets (including an asset register) as required by section 63(2)(c) of the MFMA.

Expenditure Management

39. The accounting officer did not take reasonable steps to prevent [unauthorised expenditure/irregular expenditure and/or fruitless and wasteful expenditure], as required by section 62(1)(d) of the Municipal Finance Management Act.

INTERNAL CONTROL

40. In accordance with the PAA and in terms of *General Notice 1111 of 2010*, issued in *Government Gazette 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in

the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

41. Management did not exercise effective oversight of reporting, compliance with laws and regulations and internal controls. This has been the main cause for the findings raised during the audit.
42. Not all the external audit findings of the prior year had been addressed, resulting in recurrent findings and persisting weaknesses in the control environment. An audit action plan has been developed, but effective implementation and monitoring of this plan did not occur.
43. Reporting against predetermined objectives was not adequate. This was due to a lack of control over the development of performance targets, processes and controls to ensure that reporting of actual performance against targets was as per National Treasury's guidelines.
44. The municipality demonstrated a general weakness in their policy management in that there are key policies which are not in place or have not been regularly reviewed to ensure that they are in line with the current needs of the municipality. There is no tool in place (in the form of a policy register) to ensure that:
 - policies exist for all key operational areas;
 - these policies are regularly reviewed; and
 - the policy owner is clearly identified.
45. There are shortcomings in the leave management and the appointment processes within the municipality. The risk of appointing people who lack the required skills is compounded by management's failure to address this recurring audit finding. It has been a recommendation by the auditors in previous audits that management should implement a Human Resource (HR) plan for managing the municipality's human resources, but this recommendation has not been implemented.
46. Management has not implemented an information technology (IT) governance framework which would govern the IT strategy of the municipality. This would also assist management to address the risks pertaining to the municipality's IT environment.

Financial and performance management

47. There are deficiencies in record management that need to be addressed, as evidenced by the significant delays in obtaining documentation required for the audit process.
48. There is inadequate monitoring of the operations of the municipality by way of monthly and quarterly reports. This has resulted in errors which occurred during the year not being identified. These errors have, in turn, resulted in the financial statements being materially misstated and the annual performance report not being useful or reliable.
49. The monitoring of compliance with laws and regulations is inadequate. This has resulted in the non-compliance findings raised during the audit.

Governance

50. A risk assessment was conducted for the municipality; however, the action plan which was compiled to address these risks was not adequately implemented. This was due to the internal audit unit being under-resourced.

51. There is also a concern regarding the independence of the internal auditor since the internal auditor is sometimes required to perform administrative duties within the municipality.
52. The audit committee is in place, but needs to improve its performance to ensure an improvement for the municipality as whole regarding financial administration and reporting, reporting against predetermined objectives and compliance with laws and regulations.

Auditor - General

East London

30 November 2011



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence